Small business restructure roll-over

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1. ***Introduction***

The Small Business Restructure Roll-over[2] is a unique feature of Australia's tax landscape, providing income tax relief to small business owners when restructuring their affairs. This represents a welcome relief for owners that seek to ensure their structure appropriately reflects the activities of their business, whilst also improving the efficiency of their operations.

While it provides flexibility, the provisions of this roll-over are quite strict and the eligibility requirements, together with the accompanying benefits, are discussed in this paper. A number of practical matters and insights have also been identified to assist advisers and small to medium enterprises (SMEs) when considering whether to apply the roll-over to their specific circumstances.

2. ***Setting small business tax policy: the current landscape***

Small business tax policy is an area that has been constantly evolving. Over recent years, there have been a number of tax concessions aimed at making it easier for small businesses to navigate the complexities of the tax system, encourage growth, and remove tax costs from small business transactions.

A few examples over the last twenty years includes, inter-alia, the following:

- former simplified tax system for small businesses;
- former small business goodwill exemption;
- small business CGT concessions;
- former entrepreneurs' tax offset;
- simplified trading stock rules;
- fringe benefits tax exemptions;
- simplified goods and services tax rules (cash basis election).[3]

[1] Dr Pizzacalla thanks the Board of Taxation Secretariat for its assistance in preparing this paper.
[2] Subdivision 328-G of the *Income Tax Assessment Act 1997*. All references in this paper are to the *Income Tax Assessment Act 1997* unless stated otherwise.
[3] Biagio Marco Pizzacalla, 'Developing a Better Regime for the Preferential Taxation of Small Business' (2014) PhD Thesis. Refer to Chapters 6 and 7 for a comprehensive analysis of Australia's small business concessions.

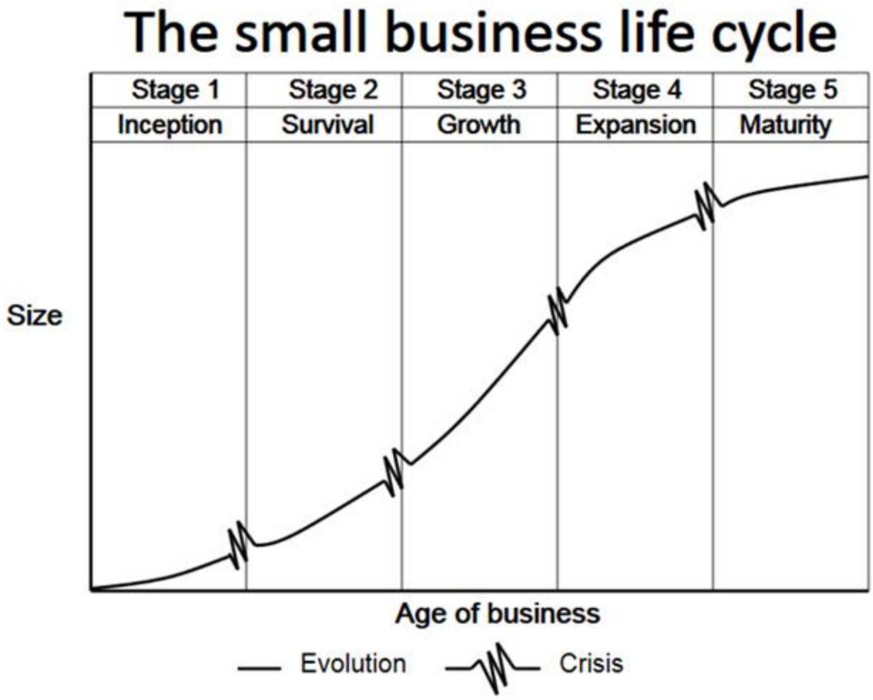
These concessions have had varying degrees of success. Notwithstanding, as a tax adviser to small business, it is important to be aware of all the relevant concessions to identify those which will be best suited to the SME's needs and requirements.

More recently, SME policies have included the following:

- $20,000 instant asset write off;[4]
- small business tax cuts (to 28.5% from 1 July 2015 and the proposed 27.5% from 1 July 2016);[5]
- unincorporated small business tax discount.[6]

Over the years, I have become convinced that determining which concessions should be introduced and the level of their effectiveness can be gauged by first working out the small business life cycle that the SME is in at any given time (refer Diagram 1). There are a number of different SME models which can be used for this purpose, each of which focuses on the start-up through to maturity stages.[7] For example, in stage 5 (maturity) a small business owner may be interested in selling the business and, therefore, would like to be in a position to access the small business CGT concessions. However, whether the structure was appropriately set up to take advantage of this concession may be another matter. Conversely, in the early stages of growth, it is cash flow which is critical.[8]

Diagram 1



[4] Section 328-180.
[5] Section 23 of the *Income Tax Rates Act 1986*.
[6] Subdivision 328-F.
[7] Pizzacalla, above n 3. Refer to Chapter 4 for a comprehensive analysis of the SME life cycle stages.
[8] Mel Scott and Richard Bruce, 'Five Stages of Growth in Small Business' (1987) 20(3) Long Range Planning, 45.

An understanding of the life cycle of a small business also assists in determining whether the structure of the business continues to be relevant; that is, whether to operate as a sole trader, incorporate a company, hold assets in a family trust, or a combination of these structures as the business changes and evolves. The relevant factors when determining structure includes, inter-alia, the following:

- access to (or need to attract) capital;
- compliance costs;
- flexibility;
- personal liability; and
- tax.

These factors are important to ensure that the structure used enhances the running of the business rather than be a hindrance. Unfortunately, as can be seen through the life cycle model, a small business is not static. This means that it is necessary to consistently review the small business operations to ensure that the structure has not become burdensome.

There are a variety of reasons as to why a structure may no longer work, for example:

- the business has continued to grow and develop;
- there are unnecessary compliance costs;
- better structures could enhance business efficiency;
- the business could move into a more efficient structure; or
- to adapt to current conditions.

While it may be preferable to change structures to try and accommodate some of these issues, prior to 1 July 2016 restrictive tax costs made it difficult for a small business to restructure to a more efficient structure.

3. Small Business Restructure Roll-over: overview

In the 2015-16 Budget, the Federal Government announced a small business tax package to encourage growth in small businesses.[9] A major component of this package was the Small Business Restructure Roll-over (SBRR), a measure that provides income tax relief for the transfer of assets when small businesses restructure their affairs.[10] It received Royal Assent on 8 March 2016 and has been in operation since 1 July 2016.[11]

This roll-over is unique because it allows for small businesses to transfer 'active' assets of a small business held personally, in partnership, by a company, or via a trust to any other small business

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[9] Australian Government, *Budget 2015-16: Growing Jobs and Small Businesses*, < http://budget.gov.au/2015-16/content/glossy/sml_bus/html/index.htm> accessed on 24 February 2017.

[10] Section 328-420.

[11] *Tax Laws Amendment (Small Business Restructure Roll-over) Act 2016* (Cth).

entity (SBE) structure provided certain conditions are met.[12] This provides greater flexibility to small businesses seeking to change structures and enhance the efficiency of their affairs.

It is also important to note that the roll-over applies not only to CGT assets but also to trading stock, revenue assets and depreciating assets. It provides for owners to defer gains or losses on these assets until a subsequent taxing point (rather than at the time of restructuring).

4. SBRR: eligibility

The SBRR appears in Subdivision 328-G of the *Income Tax Assessment Act 1997.* The eligibility conditions for the roll-over are as follows:

1. transfer of assets must be part of a 'genuine restructure of an ongoing business';
2. each party to the transfer must be:
    a. a SBE when the transfer occurs;
    b. an entity who has an affiliate that is a SBE for that income year;
    c. an entity who is connected with an entity that is a SBE for that income year; or
    d. an entity which is a partner in a partnership that is a SBE for that income year,
3. the transaction does not materially change the ultimate economic ownership that an individual has in each asset;
4. the asset must be an active business asset at the time of the transfer;
5. the transferor and transferee must be Australian residents for tax purposes; and
6. the transferor and transferee must each choose to apply the roll-over.

Many of the terms used in the criteria are common to other small business concessions, such as the 'small business entity' definition, the 'affiliate' and 'connected with' tests and whether an asset is an 'active asset'. Further, it is on an asset-by-asset basis similar to many other CGT roll-overs.[13] These familiarities will assist when practically applying the concession as advisers will be aware of most of the provisions.

However, this is not the case with all of the six criteria. In particular, there are two conditions that require some further analysis as they are unique to the SBRR. These are:

1. requirement for a 'genuine restructure of an ongoing business'; and
2. requirement to not materially change the 'ultimate economic ownership' of the asset.

These concepts are explored further below, together with some practical insights. The eligibility criteria are addressed, in turn, below.

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[12] Section 328-110 broadly states that an entity is a SBE in an income year if it carries on a business and its aggregated turnover is less than $2 million (the turnover test). There are a number of exceptions and concessions in these rules that are not explored in this paper. The turnover test is elaborated on in section 4.2.
[13] See Division 122 and Division 124 for examples of CGT roll-overs, in particular Subdivisions 122-A and 122-B (disposal of assets by an individual/trustee to a company or by partners in a partnership to a company, respectively).

4.1. SBRR: genuine restructure

The requirement that a roll-over be undertaken as a genuine restructure of an ongoing business is an integrity measure intended to ensure that only restructures that genuinely improve the performance of a small business are undertaken.

The ATO has provided guidance regarding what features might indicate that a transaction is, or is part of, a genuine restructure as follows:

- it is a bona fide commercial arrangement;
- the business continues under the same ultimate economic ownership;
- the transferred assets continue to be used;
- the new structure is the one likely to have been adopted originally had the owners obtained professional advice;
- the restructure is not unduly tax driven.[14]

These factors are of some assistance to advisers when considering whether clients are able to access the SBRR; however, there may still be some level of uncertainty regarding the operation of this test.

In this regard, the provisions include a 'safe harbour' rule. This alternative to satisfying the 'genuine restructure' requirement broadly requires that there is no change in the ultimate economic ownership of any of the significant assets of the business for three years following the roll-over.

More specifically, the requirements to qualify for the safe harbour rule are:

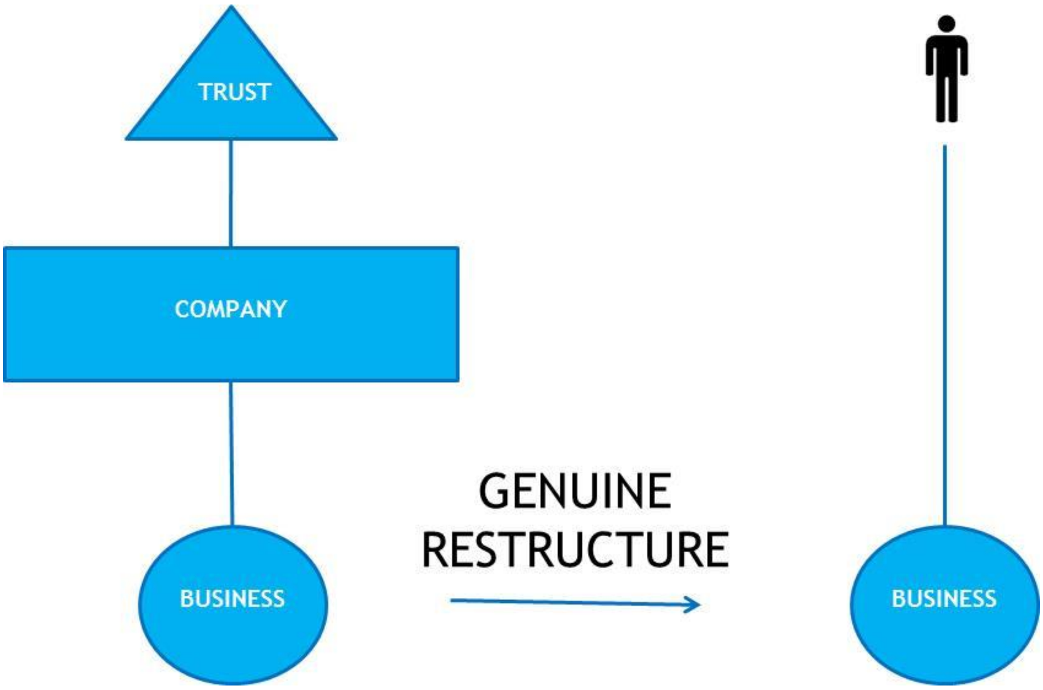
1. there is no change in the ultimate economic ownership of any of the significant assets of the businesses that were transferred (except trading stock);[15]
2. those significant assets continue to be active assets;[16] and
3. no significant or material use of those significant assets for private purposes.[17]

Practical insights / observations

There are a few issues in relation to the genuine restructure requirement that can benefit from some industry experience / observations of the rules since enactment. A helpful resource for obtaining an understanding of what transactions will qualify is the ATO's Law Companion Guideline LCG 2016/3, as this provides a number of examples directly on point. Some of these examples are discussed below in more detail.

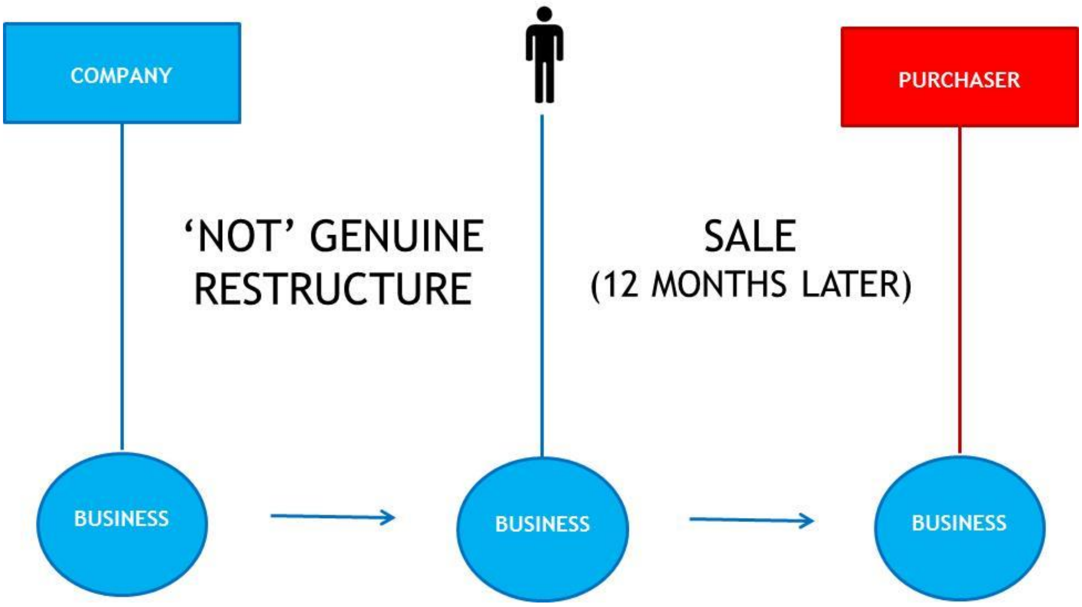
[14] For more information, please see the ATO's Law Companion Guideline LCG 2016/3 *Small Business Restructure Roll-over: genuine restructure of an ongoing business and related matters*.
[15] Paragraph 328-435(a).
[16] Paragraph 328-435(b).
[17] Paragraph 328-435(c).

Example 1



In this example,[18] a small business has simplified its operations from a company owned by a family trust to holding assets personally as a sole trader. The example states that doing so for the purpose of reducing ongoing costs, such as accounting fees, and recognising the modest income of the business, will satisfy the definition of a genuine restructure.

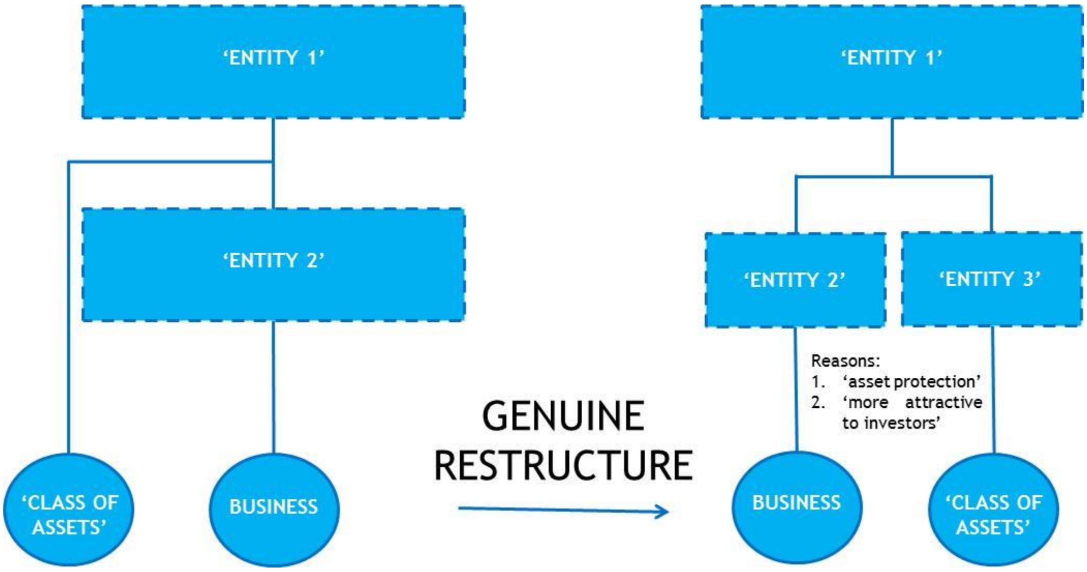
Example 2



[18] Australian Taxation Office Law Companion Guideline LCG 2016/3 *Small Business Restructure Roll-over: genuine restructure of an ongoing business and related matters*, paragraph 37.

In this example,[19] this small business owner sought to structure its affairs in order to facilitate the most tax advantaged method of sale to another party. The example states that this is not a genuine restructure. It is important to recognise that, as the owner has no expectation of continuing to run the business after the transfer, the restructure provides no commercial benefits and leads to a failure of this test. The result may well be different were the restructure to qualify for the safe harbour rule (such that the business ran in the owner's hands for another three years) with an intention to improve business operations prior to sale.

Example 3



As well as the LCG, the ATO has recently released a Private Ruling,[20] on which this final example is based. This example demonstrates how the restructure was undertaken, by inserting another entity into the business structure. Given the new entity (entity 3) was intended to hold a certain class of assets (for example, passive assets such as land), it is possible that entity 3 is a trust; further, entity 1 is likely to be an individual since the ultimate economic ownership can only be held by natural persons.

In this example, the ATO accepted that a restructure was genuine when undertaken for the purposes of making a business group more attractive to potential investors and to protect assets from business risk. While it is reasonable to expect small business owners to improve asset protection, it is worth considering what 'making a business group more attractive to potential investors' might entail. To what extent can the group be made more attractive? For example, if a potential investor thought the group was so attractive it sought to buy the group completely, does this situation differ from example 2? The likelihood may well be that it does, but these questions were not required to

[19] Ibid, paragraph 45.

[20] Australian Taxation Office, Private Ruling PBR 1013065876070 <https://www.ato.gov.au/rba/content/?ffi=/static/rba/content/1013065876070.htm> accessed on 24 February 2017.

be addressed in the ATO's ruling. They are, nonetheless, worth considering by advisers in the course of evaluating whether a restructure would be otherwise genuine.

These examples should assist advisers when considering the scope of the SBRR. While there are many examples in the ATO's LCG 2016/3, there are other technical considerations regarding the genuine restructure requirement that have also been identified. In particular, advisers should also consider the following matters for relevancy to their clients' circumstances:

- *Safe harbour:* given the requirement for maintenance of ultimate economic ownership (and limiting private use) over three years, it will be important to maintain contemporaneous documentation of any use and sale of significant assets of the small business group. This increased compliance should be factored into any consideration of the advantages of restructuring.
- *Anti-avoidance:* the ATO's LCG 2016/3 states that Part IVA (the general anti-avoidance rules) can still apply to a restructure notwithstanding the satisfaction of the safe harbour rule. The LCG does not elaborate on how the ability of the Commissioner to apply Part IVA would operate in this context; its application would have to address why the specific exclusion of transactions that simply make a choice or election available under tax law does not apply.[21] Notwithstanding, advisers should be wary of the potential for aggressive restructures to be subject to prolonged compliance action from the ATO.

4.2. <u>SBRR: who can access the roll-over: Small Business Entities</u>

As noted above, to access the SBRR, each party to the transfer of an asset must be either a SBE, an affiliate or connected with a SBE, or a partner in a partnership that is a SBE.

It is noted that the definition of Small Business Entity is currently linked to the SBRR and the corporate tax cuts currently before Parliament.[22] While the current turnover test is $2 million, this is scheduled to increase to $10 million and will apply to the SBRR (but not the small business CGT concessions).[23] If passed, this will make the SBRR available to a wide variety of businesses and makes awareness of the eligibility requirements even more important. The ATO stated that taxpayers should submit returns in accordance with the law current at the time of lodgement. Should the new law be enacted:

> *"[The ATO] will identify those tax returns that have been processed and are eligible for the 27.5% tax rate. We will contact them and we will amend their return. We will pay interest on overpayments of tax."*[24]

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[21] Subsection 177C(2) of the *Income Tax Assessment Act 1936*.
[22] Section 328-110.
[23] *Treasury Laws Amendment (Enterprise Tax Plan) Bill 2016* introduced to the House of Representatives on 1 September 2016.
[24] Australian Taxation Office, *Reducing the corporate tax rate* <https://www.ato.gov.au/General/New-legislation/In-detail/Direct-taxes/Income-tax-for-businesses/Reducing-the-corporate-tax-rate/> accessed 24 February 2016.

4.3. Ultimate Economic Ownership

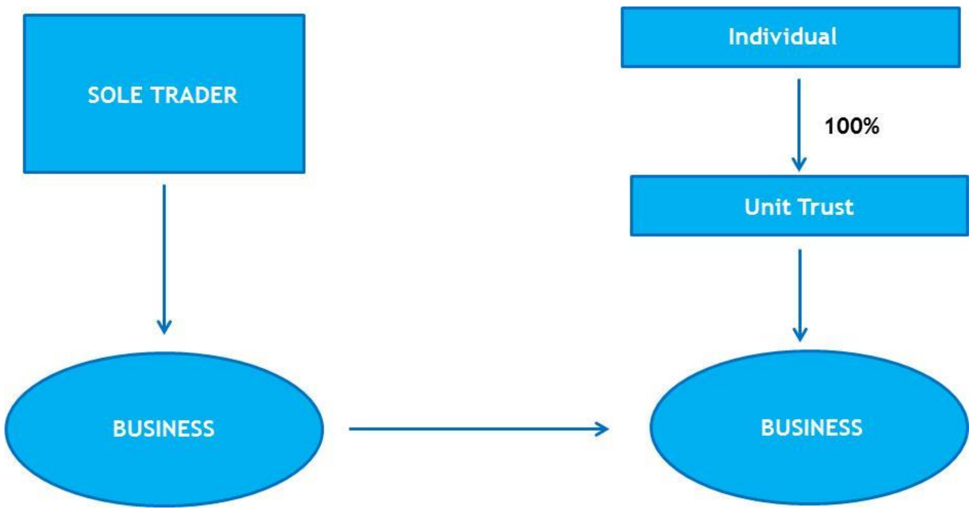
The requirement that each party be a SBE or satisfy one of the ancillary definitions is supplemented by the requirement that a transaction not have the effect of materially changing the ultimate economic ownership of any asset. This applies to individuals, as well as to jointly held assets by requiring that each individual's share of the ultimate economic ownership not materially change. This is a relatively straightforward test that should be similar to other circumstances (such as other CGT roll-overs) in which it is important to calculate the ownership proportions precisely.

The SBRR is unique, however, in that it allows for a discretionary (family) trust to be a party to a SBRR transfer. In order to facilitate this, an alternate test for ultimate economic ownership was provided.[25]

The alternate test requires that the asset transferred under the SBRR must be trust property either (or both) before or after the transfer, and is only available to discretionary trusts that have made the family trust election. To meet the test, every individual that has ultimate economic ownership of the transferred asset must be a member of the family group relating to the family trust.[26]

These concepts are best explained through worked examples.

Example 4



In this example,[27] the personally held assets are transferred to a unit trust in which the units are wholly owned by the previous owner. There is no change in ultimate economic ownership as the former owner of the assets now owns the entity that owns the assets.

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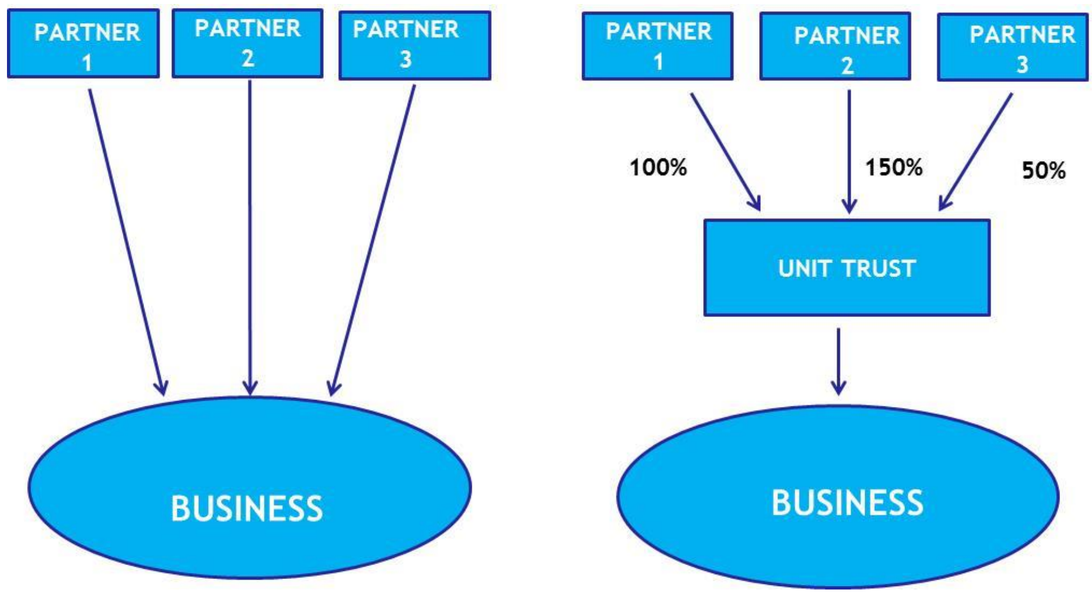
[25] Section 328-440.

[26] This aligns with the trust loss rules in Schedule 2F of the *Income Tax Assessment Act 1936.*

[27] Explanatory Memorandum to the *Tax Laws Amendment (Small Business Restructure Roll-over) Act 2016* (Cth), Example 1.1, pp 10.

Example 5

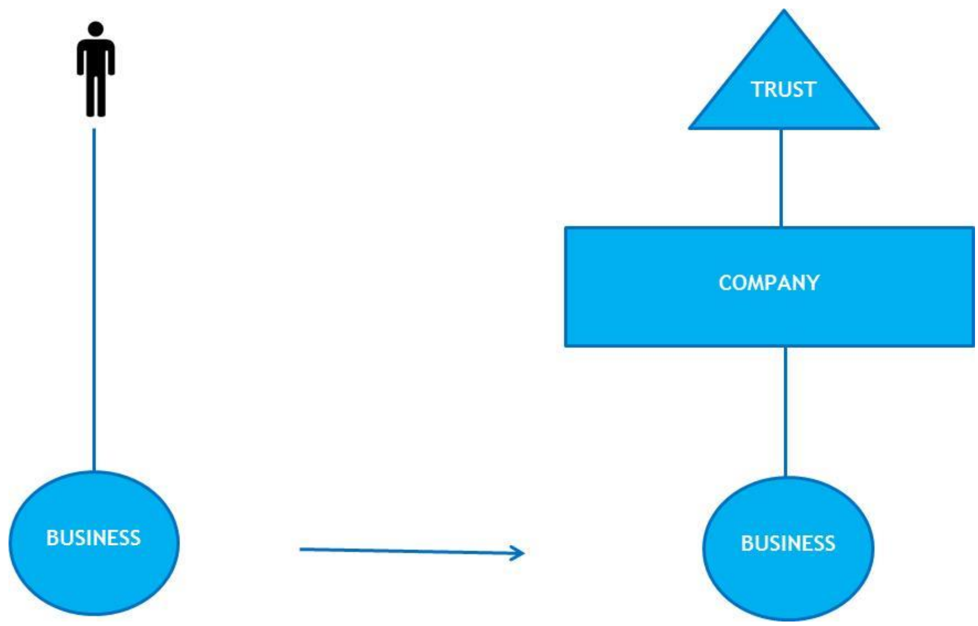


In this example,[28] in much the same way as the first example, the former owners now own the entity that owns the assets. However, as the joint owners have not maintained their share of ownership in the same proportions, they do not satisfy the ultimate economic ownership test.

Practical insights

Further analysis and application of these rules has highlighted that the ultimate economic ownership rules have very strict requirements with which each SBE must comply.

Example 6



[28] Ibid, Example 1.2, pp 11.

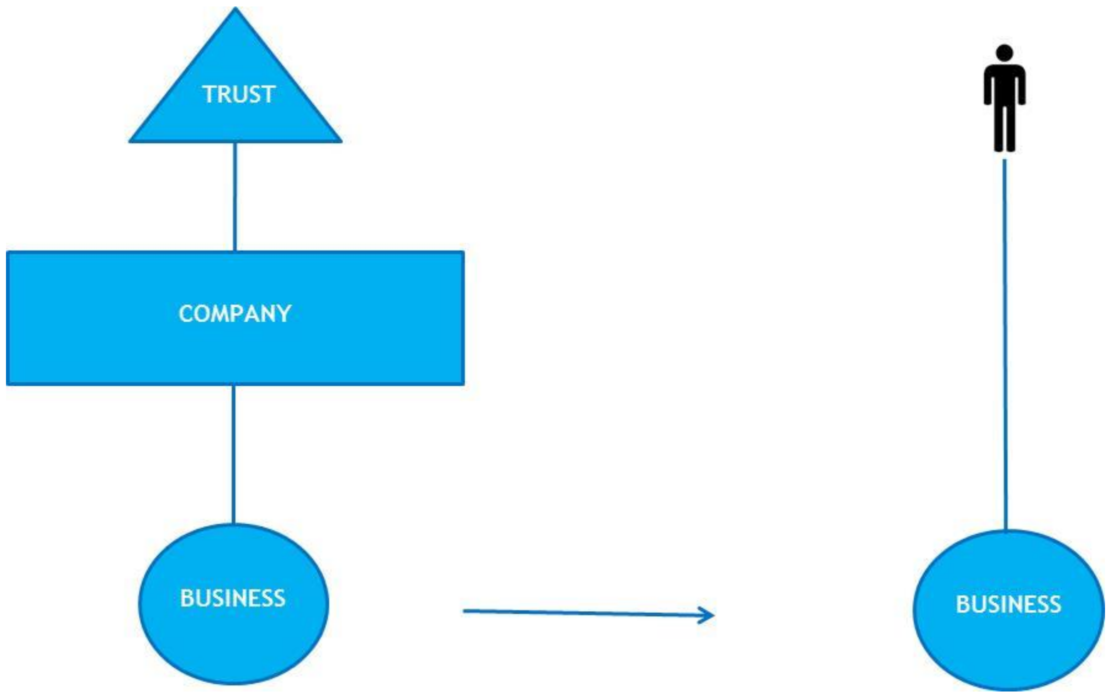
This is perhaps best demonstrated in the ATO's first Private Ruling on the subject whereby the ultimate economic ownership was not found to be maintained when transferring assets into a family trust.[29] In this ruling, a sole trader transferred assets to a company owned by a family trust (of which the sole trader was the test individual). Taking a technical legal position, the ATO stated that the assets do not form 'trust property' as required by the alternate ownership test for family trusts as the assets are actually owned by the company – the shares in the company are the only trust property and as they were not transferred, the test is failed.

The ATO stated that:

> *"[T]he family trust will wholly own the company, and therefore it could be argued that in effect the assets will form part of the property of the family trust. However, the wording in subparagraph 328-440(a)(ii) is very specific and we do not consider that it can be interpreted that broadly. After the restructure the assets will be included in the property of the company rather than the family trust. It is the shares in the company that will be included in the property of the family trust."*[30]

While this position may seem quite strict, maintaining ownership is of fundamental importance to the SBRR policy. Other examples further demonstrate the strictness of the law in this regard.

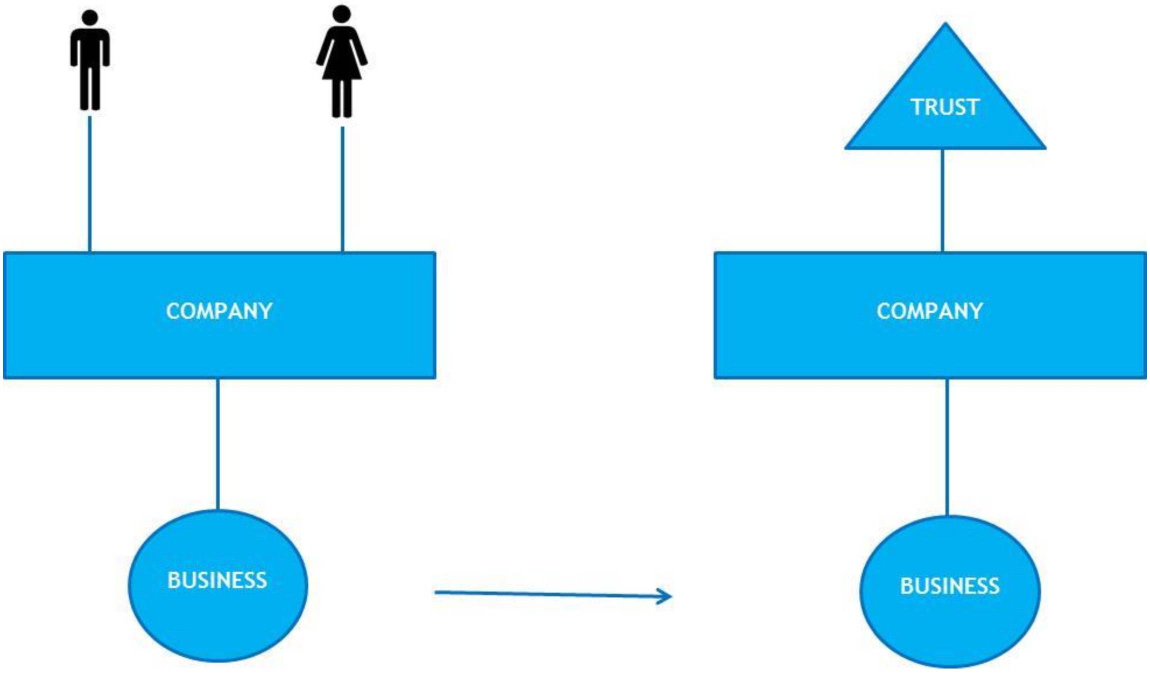
Example 7



[29] Australian Taxation Office, Private Ruling PBR 1013065150311 <https://www.ato.gov.au/rba/content/?ffi=/static/rba/content/1013065150311.htm> accessed on 24 February 2017.
[30] Ibid.

In this example,[31] unusually, the taxpayer does not need to satisfy the alternate test even though a family trust is involved, as the ATO states at paragraph 44A that the individual has 'no family members' and, therefore, satisfies the primary test for ultimate economic ownership. It is questionable this example will apply much in practice, where an individual has no family members as well as no entities that may be objects of that individual's family trust.[32] It is worth noting the risk here that, just because a restructure may go from one structure to another, it cannot be assumed that it can also work in the opposite direction.

Example 8



Similar to the ATO's private ruling, a restructure of this nature could be problematic if the assets were transferred between two companies (as they do not satisfy the 'trust property' requirement). However, if the two individuals are within the same family group, they may transfer the shares in the company to the trust and satisfy this requirement, provided the shares satisfy the 'active asset' test.[33]

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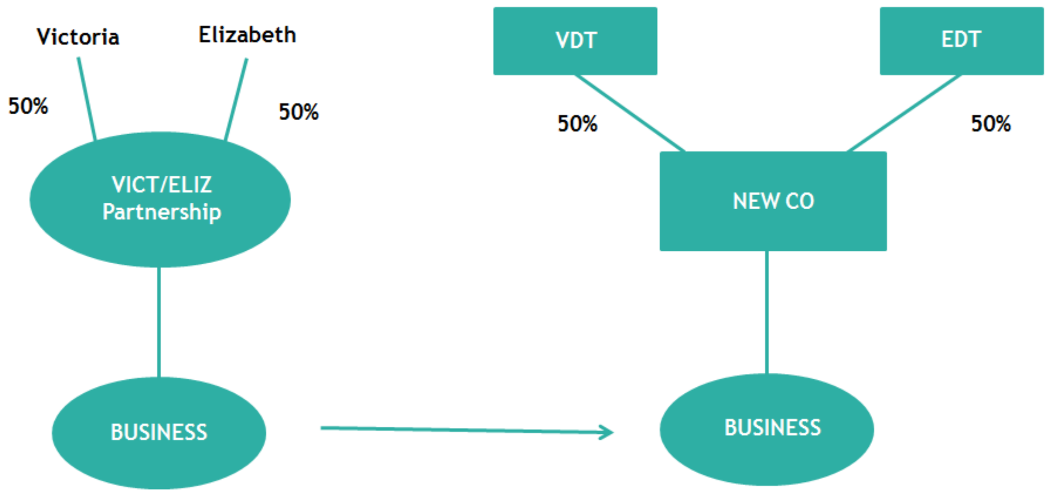
[31] Australian Taxation Office Law Companion Guideline LCG 2016/3 *Small Business Restructure Roll-over: genuine restructure of an ongoing business and related matters*, paragraph 37. Example 13 from LCG 2016/3 is similar. In example 13, family members that own a company running their small business transfer the assets of the company to their family trust directly. The family trust satisfies the alternate test as, immediately after the transfer, the assets are trust property. While over time, if the trustee wanted to run the business through a company it could subsequently access Subdivision 122-A to transfer the assets into a company owned by the trust, but the timing of any subsequent roll-over will need to be evaluated for its commercial and tax reasons (including Part IVA).

[32] It is noted that the correctness of this position at law has been questioned: Dung Lam, Mark West and Alex Whitney (2016) 'Practically using the small business restructure rollover' *Tax Institute of Australia 2016 SME Tax Symposium*.

[33] It is noted that a roll-over under Subdivision 122-A might appear to be available to roll personally held assets into a company prior to using the SBRR to achieve this same result. However, back-to-back roll-overs are

Example 9



In this example[34], a partnership is unable to satisfy the alternate test when restructuring into a common business structure of two family trusts owning shares in a newly established company to carry on the business of the partnership. Similar to the ATO's private ruling, this example states that the primary test cannot be satisfied by the discretionary trust. Further, as the transferred assets are not 'trust property', merely company assets, then the alternate test is failed.

Having regard to the foregoing, whenever a family trust is disposing of or receiving assets under the SBRR, it is important to identify the level at which the asset is held (i.e. is it 'trust property'?). It is also important to ensure that the trust has made the requisite Family Trust Election as part of the restructuring process.

4.4. Active assets of a SBE

There are two ways that a party to a transfer pursuant to a SBRR can satisfy the active asset requirement:

1. if the entity is a SBE (or a partner in a partnership that is a SBE), the transferred asset must have been an active asset of the transferor's business; or
2. if the entity is not a SBE (qualifying for the SBRR as an affiliate, connected with a SBE or partner in a SBE partnership), the transferred asset must be an active asset in relation to which subsection 152-10(1A) of the *Income Tax Assessment Act 1997* is satisfied.

For the first test listed above, the definition of 'active asset' is taken from the small business CGT concessions in Division 152 of the *Income Tax Assessment Act 1997*. It is worth noting that this does

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generally not favourably received by the ATO and in particular can be subject to Part IVA of the *Income Tax Assessment Act 1936* as they fall outside the 'choice or election' exception mentioned earlier.

[34] Example 12 of Australian Taxation Office Law Companion Guideline LCG 2016/3 *Small Business Restructure Roll-over: genuine restructure of an ongoing business and related matters*, paragraph 103.

not require an asset to satisfy the 'active asset test' (being a time based test), merely that the asset is an active asset.[35]

It is sufficient that the asset is used, or held ready for use, in the course of carrying on a business and includes tangible and intangible assets. Be mindful, however, that this is subject to a number of restrictions regarding financial instruments, trust interests and shares (widely and closely held).[36]

For the second test, while the transferred asset must satisfy the definition of active asset as outlined above, it is necessary to do so as an active asset of the SBE to which the entity is affiliated or connected with. This test acknowledges that while the entity may not be carrying on business in which the asset is used, it may qualify if the asset is used by the SBE that is restructuring under the SBRR as one of its active assets.

4.5. Residency requirement

Each entity that is a party to the SBRR must satisfy the residency requirements. This includes every transferee and transferor in relation to each transfer made under the SBRR. The particular residency requirements are:

1. an individual or company must be an 'Australian resident';
2. a trust must be a 'resident trust for CGT purposes'; or
3. a partnership (other than a corporate limited partnership) must have at least one part that is an 'Australian resident'.[37]

These concepts are generally well known within income tax law.

An important consideration here is that, while a trust must be a resident trust, beneficiaries of the trust (in particular, any member of a family group of a family trust) can be non-residents. This is particularly important for family trusts so that if a child or sibling of the test individual (which may well be likely in the modern environment) is a non-resident the family trust will not fail this requirement.

4.6. Choice for SBRR to apply

The final criteria to qualify for the roll-over is that each entity to the SBRR must choose to apply the roll-over in relation to assets transferred to them. This choice affects the tax consequences of the transaction for the choosing entity.

Importantly, this choice must be made in respect of all assets transferred under the SBRR. This may make it difficult to carve out asset transfers from the scope of the SBRR if they are transferred as

[35] Lam, West and Whitney, above n 32, pp 5.
[36] These exceptions are stated in section 152-40 and should be familiar to anyone who has previously applied the small business concessions.
[37] For more information see section 328-445.

part of the restructure[38] and, arguably, provides for an appropriate outcome to maintain the integrity of the concession.

5. SBRR: tax effects

As noted above, the SBRR provides income tax relief for the transfer of assets. The precise nature of the relief is outlined in the following table.

ASSET TYPE	TRANSFEROR	TRANSFEREE
Pre-CGT asset	Tax free	Retains pre-CGT status
Discount Capital Gains (CGT Asset)	Cost base	Acquire CGT asset as at transfer time at cost base (refresh happens!)
Trading stock	Cost, or if item held at start of the income year, value at start of income year	Acquire Transferor's cost and other attributes
Revenue assets	Amount that results in no profit or loss	Acquires Transferor's cost attributes
Depreciating assets	Roll-over relief under s.40-340 – cost which would result in a nil balancing adjustment	Acquires Transferor's depreciation method and effective life

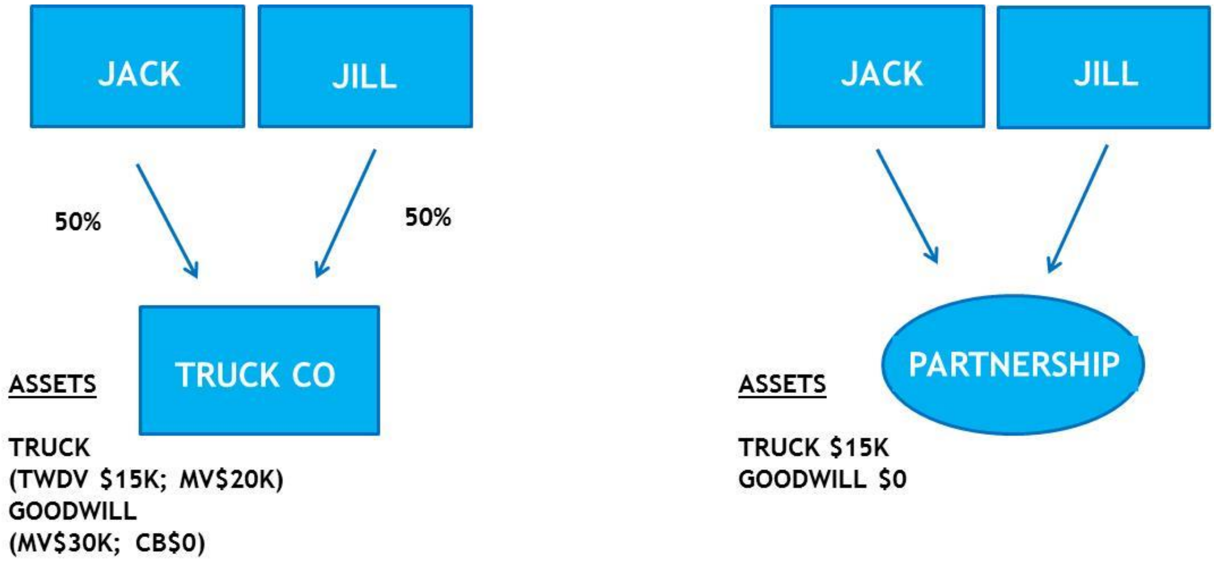
It is important to recognise that when a CGT asset is transferred, there is no deemed acquisition date for CGT discount purposes. While this is different to other roll-overs, the policy underpinning the SBRR is to restructure an ongoing business rather than ready the business for sale. This effectively means that the discount will not be available until twelve months after the date of asset transfer. Whilst the policy rationale is sound, caution needs to be exercised as this has the potential to be a 'trap' when advising on restructures as it can be easily overlooked.

[38] Lam, West and Whitney, above n 32, pp 32.

6. Effect of restructure on transferred costs of assets

The following example is from the Explanatory Memorandum,[39] and illustrates the practical outcomes of a restructure, admittedly in 'plain vanilla' type situations. As is shown, Jack and Jill restructure their affairs from running a small business together through a company to running the small business as a partnership.

Example 10



The assets of the company 'Truck Co', being a truck and goodwill, are transferred to the partnership. The roll-over cost of the goodwill is its cost base of nil and this becomes its cost base for the partnership. The truck is a depreciating asset, and the partnership acquires the company's depreciation method and effective life. In this case, that is the tax written down value of $15,000.These costs ensure that the restructure does not attract an income tax liability while maintaining the same tax position for each asset in the transferee's hands.

7. Some final thoughts

There have been a number of issues arising in practice that could easily be the subject of another lecture or paper. Some brief thoughts on these issues are included for completeness.

7.1. Purchase consideration

a. The IPA's submission to Treasury on the SBRR Exposure Draft stated that the requirement that 'no consideration' be provided under the SBRR at that time be omitted.[40] This submission was accepted in the Bill as enacted (as can be seen from the eligibility

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[39] Explanatory Memorandum to the *Tax Laws Amendment (Small Business Restructure Roll-over) Act 2016* (Cth), Example 1.6, pp17.

[40] Institute of Public Accountants, Small Business Restructure Roll-over <http://www.treasury.gov.au/~/media/Treasury/Consultations%20and%20Reviews/Consultations/2015/Small%20Business%20Restructure%20Rollover/Submissions/PDF/Institute_of_Public_Accountants.ashx> accessed on 24 February 2017.

requirement listed earlier in this paper). This is a welcome change to ensure flexibility and to minimise any potential restrictions on the ability to restructure.

b. In some articles that have followed, practitioners have helpfully noted a number of issues that might arise in practice regarding what consideration should be paid and what might be required for nil consideration to be paid.[41] For example:

   i. Where a company transfers an asset for nil consideration, some commentators have suggested this will likely need the unanimous consent of the shareholders. Section 124 of the *Corporations Act 2001* (Cth) allows a company to gift an asset, but practitioners suggest that this be done with unanimous shareholder consent to minimise potential arguments regarding directors acting otherwise than in accordance with their good faith obligations; further, consideration of whether there is an unauthorised (or illegal) reduction of share capital may be necessary.[42]

   ii. Where a trust transfers an asset for nil consideration, careful consideration of the trust deed should ensure that such transfers are within the power of the trustee. It is more likely that the transferee would be a capital beneficiary so that they might be distributed the asset. Also consider whether a trust deed that does not contain such a power could be amended to allow such a transfer to a party that is not a beneficiary.[43]

   iii. To minimise any commercial complications, in practice, market value (arm's length) consideration could be taken into account as part of the SBRR.

   iv. Other factors to take into accounting in deciding whether to transfer for (market value) consideration include the franking position of the transferor company, consequences of subsequently transferring the asset out of the transferee company, and application of the dividend stripping rules.[44]

7.2. Long term estate planning

a. Some practitioners have considered differences between a Subdivision 122-A rollover and a SBRR for planning and tax purposes.[45] The following considerations should be taken into account when deciding which rollover to apply:

   i. Whether shares will be issued as consideration – the cost base of the shares under the SBRR are capped at the cost bases and adjustable values of the transferred assets (less liabilities assumed), while Subdivision 122-A uses the market value of precluded assets (not adjustable values). This is because

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[41] Lam, West and Whitney, above n 32 and John Iannou CTA (2016) 'Small business restructure' *Tax in Australia* vol. 51, no. 1, pp38.

[42] Lam, West and Whitney, above n 32, pp25. That is, if share capital was debited with the asset transfer instead of retained earnings (and therefore to the detriment of company creditors).

[43] Ibid.

[44] Section 177E of the *Income Tax Assessment Act 1936.*

[45] Lam, West and Whitney, above n 32, pp 32.

Subdivision 122-A requires the shares to equate to the market value of assets transferred, while SBRR is flexible in this regard.

ii. Pre-CGT assets – Subdivision 122-A deems a proportion of the shares of the transferee company to be pre-CGT assets, whereas SBRR does not.

iii. Trading stock – the SBRR covers the transfer of trading stock, whereas Subdivision 122-A does not.

b. Other considerations include whether the SBRR is available to restructure affairs to enhance ongoing business efficiency, while also providing the opportunity to hold assets such that they might access the CGT discount or small business CGT concessions.

7.3. *Other accounting and tax issues*

a. It is worthwhile considering whether paying full consideration is appropriate to ensure that the dividend stripping rules do not apply.[46]

b. The asset transfer to be debited to retained profits may lead to the transferor company having excess franking credits but no assets out of which to pay a dividend. The franking consequences would need to be considered.

c. While there is not a stamp duty exemption that aligns specifically with the SBRR, NSW, ACT, Victoria, Tasmania and SA do not impose stamp duty on non-land business assets. The other states do and it is necessary to consider which assets fall into which jurisdictions. There are also other exemptions (corporate reconstruction relief, trust cloning in certain States) that might reduce the stamp duty burden of a SBRR restructure.

7.4. Banking considerations

a. Where a sole trader transfers an asset to a company/trust for nil consideration, it is necessary to consider whether the asset will remain subject to relation back and clawback rules in the *Bankruptcy Act 1966* (Cth).[47]

b. Small business owners will need to contact creditors and banks in the process of restructuring in order to ensure that any approval that is required can be obtained.[48] For example, they may require that any new entity will assume the liability of the business, new guarantees may be provided. It is also possible that refinancing group debt could be reviewed.[49]

[46] Section 177E of the *Income Tax Assessment Act 1936.*
[47] Sections 120 and 121 *Bankruptcy Act 1966* (Cth).
[48] Lam, West and Whitney, above n 32, pp 29.
[49] Ibid, pp25.

7.5. Use of new 'clean skin' trusts

a. The SBRR does not require the trust deed of any recipient trust to have an identical meaning and effect to that of the transferor trust, only that the same test individual under an FTE has been made (a requirement that is only a point in time test, being the time of the transfer).[50] Importantly, this means that a new 'cleanskin' trust can be used to provide greater flexibility for the trustee as well as managing the risk of a trust vesting.

7.6. Value shifting integrity rules

a. The SBRR includes a rule to manage the potential for duplication of losses.[51] This rule ensures that if an entity holds:

   i. a membership interest in a transferring entity; or

   ii. a membership interest that was issued as provided for in a SBRR transaction,

   the entity disregards any capital loss arising from a CGT event in relation to the membership interest, except to the extent the entity can demonstrate the loss is attributable to a matter other than the transaction. As this rule applies to new membership interests provided as consideration for transferred assets, it is also necessary to apply the rules governing how the cost base of the new membership interests is to be calculated.[52]

8. Conclusion

This paper identifies some of the benefits and relevant matters to be considered when evaluating and implementing a roll-over under the SBRR. The ability to defer tax while improving the efficiency of business operations is a welcome addition to the income tax concessions provided to small businesses. Importantly, a number of issues which small business owners and advisers need to be aware of have been highlighted and flagged for further consideration.

It is clear that whilst some aspects of the new provisions may need to be 'ironed out', we should all remember that the SBRR provisions represent leading edge tax policy. Credit needs to be given to the Government for having the courage to proceed with these measures in the short timeframe in which they were first considered and then subsequently legislated. The SBRR is now law. It is up to practitioners and taxpayers alike to make them work and suggest improvements where appropriate.

[50] Matt Burgess CTA (2016) 'Tricks, traps and tantalising opportunities: new Subdiv 328-G explained' *Tax in Australia* vol. 51, no. 1, pp38 and John Middleton of Clayton Utz, The proposed new small business rollover – five big issues <https://www.claytonutz.com/knowledge/2015/november/the-proposed-new-small-business-rollover-five-big-issues> accessed on 24 February 2017.
[51] Section 328-470.
[52] Section 328-465.